A *review by the* **Federal Reserve Bank of Chicago**

Business Conditions

1952 May

Contents

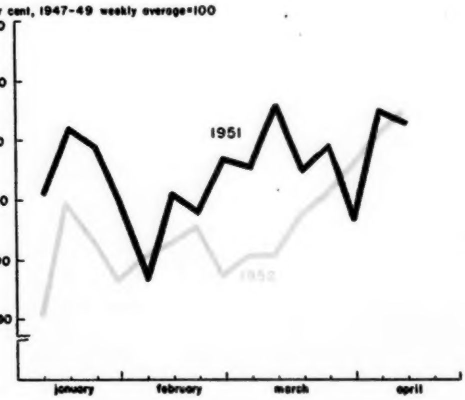
THE Trend OF BUSINESS

WITH THE USUAL SEASONAL PICKUP in many lines of activity, business sentiment appears to be developing a somewhat firmer tone. Housing starts have increased appreciably from the December low and are currently near last year's high level. Automobile sales are beginning to rise and department store sales advanced in the weeks preceding Easter. Of perhaps greater importance, the March 15 tax date is now past; tax payments will constitute a smaller drain on private purchasing power in the months ahead and Government expenditures will again tend to outrun revenues. Finally, production difficulties which would have resulted from a serious loss in steel output have been averted, at least for the time being.

The considerable amount of bearish sentiment which developed in the winter derives little support from measures of over-all business activity. Although some lines continue relatively weak, total production has advanced slightly in recent months. Unemployment in February and March was the lowest for these months since the end of World War II. Wholesale prices, which had been declining gradually for nearly a year, showed signs of leveling during March.

The reasons for this firmness in business activity are clear. Despite the stretch-out in the defense build-up, rearmament outlays continue to rise. Defense spending in the first quarter was at an annual rate of 48 billion dollars, up 4 billion from the previous quarter and 19 billion from early 1951. Moreover, business outlays for plant and equipment are continuing at record levels, while consumer spending rose to a new high in the first quarter of this year. In light of anticipated heavy expenditures by both Government and business, it seems unlikely that any significant slump in business will take place in the months ahead.

District department store sales increase seasonally to 1951 levels



Business plans to spend over 24 billion dollars on plant and equipment this year according to a recent SEC survey. This would be 4 per cent higher than the record outlays of 1951. Industries intending to increase capital spending the most this year are durable goods manufacturers and transportation groups other than railroads. Projected expenditures in the first half of the year are one-eighth larger than during the same period in 1951 with less definite second half plans showing a small decline from last year.

Corporate security issues for new capital tend to bear out these heavy spending plans. Estimated first quarter offerings were 2 billion dollars, nearly a fourth larger than in early

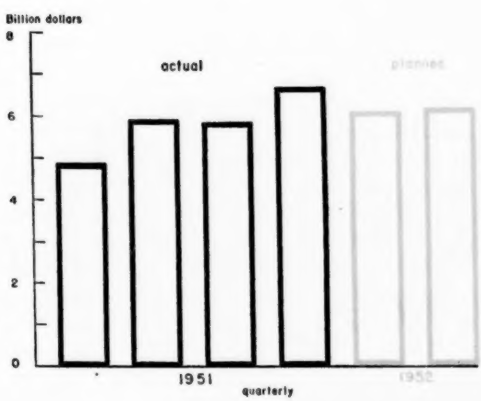
1951 or 1948 and far above other postwar years. Over half the total offerings were by manufacturing firms, with public utility issues comprising an additional 35 per cent. Large offerings of Seventh District concerns in recent weeks included a 49.5 million bond issue by Inland Steel, 25 million in bonds by Illinois Bell Telephone, 90 million in debentures by Service Pipe Line Company, and 30 million in long-term notes by Marshall Field and Company.

Consumers are planning to hold spending for durable goods at moderate levels this year, according to preliminary findings of the 1952 *Survey of Consumer Finances.* About 75 per cent of all nonfarm spending units are earning as much or more than a year earlier and 4 out of 10 expect further increases in income this year. Nevertheless, consumers are planning to buy somewhat fewer new cars and major household items, such as electrical appliances and furniture, than was the case in early 1951. Plans to buy used cars and both new and used houses continue strong, however. A significant finding is that 6 out of every 10 consumers feel this is a bad time to make large purchases, citing high prices as the major reason for this view.

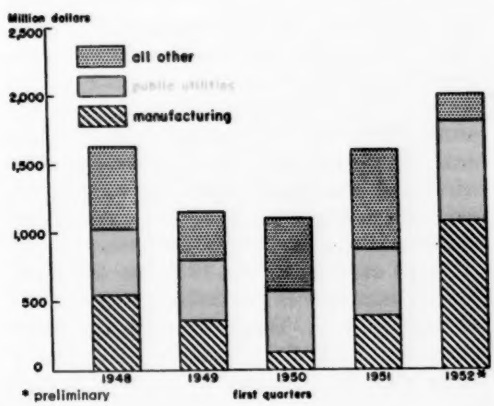
Sales at District department stores have increased sharply over the past few weeks, reflecting the usual pre-Easter buying surge. The rise brought total sales up to 1951 levels for the first time this year, but the significance of this comparison is reduced because of the earlier Easter last year. Sales of television sets, floor coverings, and major household appliances continue well below those of a year ago, despite the fact that comparisons no longer reflect the wave of heavy buying in early 1951.

Meat production in the first quarter of 1952 was substantially above a year earlier and probably will continue larger than in 1951 for the remainder of the year. Most of the increase in the first half of the year will be pork, but beef production is expected to be well above year-ago levels in the last half of 1952. Even though consumer demand has continued generally strong, prices of most meat animals have been lower this winter than last, due primarily to the larger slaughter supplies. Moreover, cold storage holdings are large.

Business outlays on plant and equipment expected to set new record for first half



Corporate security issues up sharply over other years in first quarter; manufacturing showed biggest gains



Who gets credit for defense?

District loans for defense contracts have climbed steadily in the past year. Chief borrowers: metal manufacturers.

BANK CREDIT, a vital lubricant for our industrial machine, has been flowing into defense industries in a steady stream. Over the past year, large Seventh District banks have granted over 200 million dollars net in loans to finance the execution of defense contracts. Over the same period, these banks also made net extensions of well over 100 million in loans for defense-supporting purposes, raising their total defense-associated loan expansion since March 1951 above the 300 million mark.

This information comes from a new series on larger business loans made by the nation's large banks inaugurated in connection with the Voluntary Credit Restraint Program in the spring of 1951. Clearly revealed by this new source of information is the growing importance of defense credit in the District's lending picture. As late as October 1950, defense-associated credit granted by the large banks was a mere trickle. Since April 1951, however, defense credit has climbed with surprising regularity at a rate close to 6 million dollars a week.

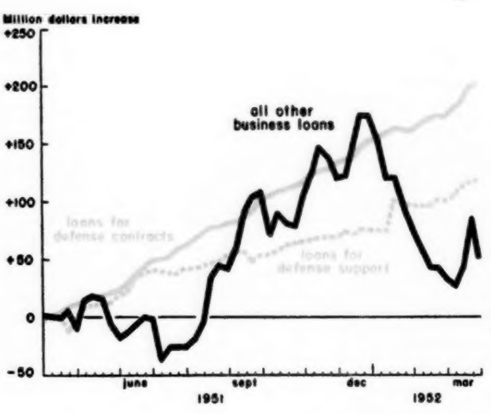
Most of the firms obtaining defense loans have not been in the industries which are heavy seasonal borrowers. Nonetheless, during the last nine months of 1951 the steady growth of such credit overshadowed the rise in seasonal loans to nondefense industries. By year-end, nondefense business loans of large District banks were 175 million above their first-quarter level, compared with a rise of 235 million in loans for defense purposes.

In the early months of 1952, the usual seasonal contraction in nondefense business borrowing appeared. This year it was abetted by retirements of bank debt on the part of some firms with the proceeds of sales of longer-term securities. By the end of March 1952, nondefense business loans had dropped 125 million. In contrast, loans for defense contracts rose another 51 million and defense-supporting loans jumped 43 million. As a result, loans for all defense purposes now account for approximately 87 per cent of the increase beyond year-ago levels in business loans at large District banks.

Credits and contracts

As could be expected, prime and subcontractors for military equipment have been the major defense borrowers. And, since roughly four-fifths of post-Korea military orders for supplies and material have been for "hard goods," metals and metal products manufacturers are by far the heaviest borrowers under defense contracts.

At large District banks, defense loans keep climbing despite seasonal drop in other business credit



This is particularly true in the Seventh District which contains a number of major metal fabrication centers. First to come to mind, of course, is the mighty automotive complex of Eastern Michigan. Together with other transportation equipment manufacturers scattered throughout the midwest, such producers have borrowed a net of over 50 million dollars from large District banks during the past twelve months. Other metals manufacturers, however, have borrowed nearly three times as much from these banks over the same period. In part, this reflects heavy placings of military orders outside the transportation equipment field; in part, also, it may reflect a smaller degree of self-financing by these other concerns. In any event, all metals and metal products firms combined account for nearly 95 per cent of the 200 million net increase in loans for defense contracts at large District banks.

Facilitating the execution of military contracts, however, is not the only function of credit in our mobilization effort. Bank loans play an important *defense-supporting* role in financing additions to plant, equipment, and working capital when needed:

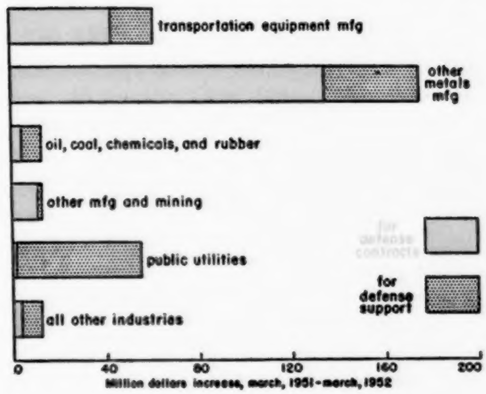
a) for the production or expansion of production of essential basic materials;

b) by transportation, communications, and public utilities.

For these purposes, large District banks have granted a net 115 million dollars in credit since March 1951. In this area, the public utilities group, in the midst of carrying through one of the greatest expansions in its history, has been the heaviest borrower. A net 53 million of such credit has been granted to these firms in the past year although most of this was extended in the second quarter of 1951.

Metals manufacturers have been a very close second in defense-supporting loan demand. In the process of increasing capacity, concerns in this field have borrowed 49 million dollars

Since last spring, metal manufacturers have led in defense borrowing



from the large banks since March 1951. About one-sixth of this increase went to firms producing transportation equipment.

Outside these two major sectors of midwest industry, the only other defense-supporting borrowing of any consequence has been by firms in the petroleum, coal, chemical, and rubber industries. In total, however, this net borrowing since March 1951 has totaled only 9 million, a far cry from the 102 million extended to utilities and metals firms.

Some further rise in defense credit appears certain, if for no other reason than to support the working capital needs of defense production. The very nature of most "hard goods" procurement necessitates sizable inventory build-ups, and these accumulations grow larger as a result of the inevitable difficulties in coordinating production schedules. Now the new "stretch-out" in the defense program will multiply the number of reschedulings and revisions of specifications. All such delays slow final payments, enhance involuntary accumulations of stocks, and increase the interim financing problems of producers. Under these circumstances, defense contractors are likely to require more extended bank financing in the months ahead.

Money for the small manufacturer

Government programs are helping small producers in defense build-up; proposals for continuing financial aids are under consideration.

THE NEED to utilize fully the resources of the small producer in the rearmament program and to prevent the development of undue concentration in manufacturing has brought the fund raising problems of the little firm to the fore once again. It is generally agreed that in time of national emergency the greater difficulties of the little firm in adjusting to changed conditions merit special consideration. Opinion is divided, however, on the need for additional financial assistance in time of all-out peace.

An adequate survey of the small business situation must view the picture in broader scope than that afforded by a depressed period or an international emergency. Concern over the adequacy of capital and credit for small firms dates back for several decades. Altogether, over 500 bills to provide financial aid to small firms have been introduced in Congress during the last 20 years. Even in the 1920's when the purse strings of individuals and institutions were loosened readily at the approach of a potential borrower there were grave pronouncements about the chronic inability of small firms to secure sufficient funds.

Unfortunately, the problem can never be brought into sharp statistical focus. It is not easy to establish objective standards as to the adequacy of funds available at any given time. Moreover, from the standpoint of efficiency, it is impossible that all should survive. A vigorous economy requires that new firms constantly enter the field.

How big is small?

There is no general agreement, but some acceptance has been accorded to a maximum of $750,000 in assets or 500 employees. The Department of Commerce has established standards which classify firms according to their relative importance in their industry. This approach to the problem results in the dividing line between "small" and "large" being drawn at a different level in each industry class, depending on its own characteristics. Thus, a "small" steel firm is huge compared to the corner bakery, but both are small beside their largest competitors. According to the Commerce standards, automobile manufacturers with up to 2,500 employees are considered "small." The dividing line for vacuum cleaner firms is 1,500 and corn products manufacturers with up to 1,000 are in the "small" category. For soap, explosives, and frozen foods the lines of demarcation are 500, 200, and 100 employees respectively. By any definition most manufacturing firms are very small. Of the 300,000 producers now in operation, 90 per cent have fewer than 50 employees and a very large number are one man affairs.

How the Government helps

In 1951, the revised version of the Defense Production Act provided for a Small Defense Plants Administration whose primary functions are similar to those of the Smaller War Plants Corporation of World War II—to help small manufacturers get Government contracts and adequate financing. The SDPA has worked toward these ends in cooperation with the House Small Business Committee.

Loans to defense contractors or subcontractors are facilitated by the V-loan guarantee program which has been in operation since the fall of 1950. Under this program procurement

offices, through the agency of the Federal Reserve Banks, assure repayment of loans used to finance defense work.

Federal legislation of the 'thirties empowered the RFC and the Federal Reserve Banks to enter into those credits which give good prospects of repayment, but which cannot be placed at reasonable terms through private channels. Business loans of the Federal Reserve Banks have been few in number during the postwar years. Partly, this is because they are required to limit lending to established firms for working capital purposes only. The RFC has much broader lending authority. During 1948 and 1949 it approved 8,100 loans totaling about 1 billion dollars. A large proportion of the loans went to small manufacturers.

The new manufacturers

Most small producers have been able to start operations and grow without the use of the programs described above. A general survey of the experience of new firms which began operations in the postwar years sheds light on the needs of the future.

In the 1946-48 period the growth of the business population was rapid as a result of rising levels of business activity and the large number of firms which had gone out of business during the War. The Department of Commerce has calculated the initial investment of the manufacturing firms which started business in the years 1946-48 at about 2 billion dollars (see table). Approximately 60 per cent of this amount was supplied in the form of equity investment by entrepreneurs. Parent companies, relatives, partners, suppliers, and banks provided most of the remainder.

Apparently, it has not been too difficult for a firm to start in recent years. About one-third of all manufacturing concerns now in operation were begun since the war. How well have the new firms done once they were launched? Evidence is inconclusive but in a recent Department of Commerce study which covered the year ending June 30, 1950, 85 per cent of the small manufacturers polled expressed satisfaction with the outside sources of funds available to them.

Sources of funds for new manufacturing corporations, 1946-48

	Asset size		
	Under 20,000	20,000-50,000	50,000-100,000
Total	100%	100%	100%
Capital stock			
Officers and directors	74	70	58
Parent company	5	6	9
General public	2	1	5
Supplier credit			
Merchandise	1	3	4
Equipment	4	4	3
Bank loans			
Non-mortgages	2	2	4
Mortgages	1	2	6
Other sources	12	12	10

Credit sources have broadened

Bank lending to small manufacturers has been facilitated in recent years by the development of new security devices and lending terms. In addition, credits have been easier to obtain as a result of better record keeping and control of inventories and costs. Over the past two decades lending on a broader class of collateral including receivables, warehouse receipts, and trust receipts has become more common. In addition, more banks than formerly have small business loan departments and some belong to credit groups or have correspondent bank connections. Such arrangements enable them to initiate and participate in loans which would otherwise be too large for them to handle alone.

Term bank loans, one to five or more years in duration, were rare prior to the 'thirties.

Since then the development of the principle of amortization and instalment loans for the purchase of equipment has been rapid. Unfortunately, the smaller firm which has the greatest need for the term loan may have the most difficulty in obtaining one, particularly in the five to ten year category. Granting money for a term of years may require an expectation of permanence which the small or new firm cannot provide. About 50 per cent of the firms that started in manufacturing in 1946-48 were out of business two years later.

Among the nonbank credit sources, trade creditors are by far the most important. Suppliers of goods carry their customers on open book account; sellers of equipment sometimes offer instalment loans on new equipment. Large customers aid their suppliers with direct loans or advance payments. In this type of credit operation the small firm must beware of tying itself to the apron strings of its larger associate, but in most cases the arrangements are mutually helpful. One party is better assured that supplies will be available and the other that markets for its products will be at hand.

Other organizations which are available to the small firm are the factors which purchase receivables outright and the commercial finance companies. In earlier decades the operations of factors were largely confined to certain industries such as textiles, but in recent years these organizations have been established throughout the country and serve a variety of clients. Many finance companies will consider a broad range of risks of a marginal nature.

Equity is more difficult

An insufficient cushion of ownership funds is often the block to additional borrowing. Nevertheless, there is a good deal of evidence to indicate that small firms generally are not interested in obtaining outside ownership funds if some measure of control or profitability for the original owners must be sacrificed. The unfilled demand for term loans of long maturity is really a desire for a source of funds which provides the advantages of equity without the drawbacks.

The main, almost exclusive, source of additional equity funds for small independent firms always has been retained earnings. Thus, high corporate tax rates are likely to hit small firms more severely than large. The impact of the excess profits tax has tended to be particularly hard on smaller concerns despite the fact that certain amendments to the 1951 Revenue Act provided a special "growth formula" for firms started since the War.

The 1950 Revenue Act, which eliminated the heavily taxed "notch" between 25,000 and 50,000 dollars of taxable income and which provided a five year carry-forward and one year carry-back for losses in contrast to the two year carry-back and forward which had prevailed, was especially intended to aid small new firms. Most plans to aid small business put tax concessions high on the list of priorities.

After the emergency

In 1949, a variety of bills intended to permanently ease the flow of funds to small business were introduced in Congress. These plans included insurance of small business loans, establishment of national investment companies, and expansion of Government lending programs to business. If the inflationary potential of the international emergency is replaced by a period of stiff competition it is likely that many of these proposals to aid small business will be revived.

Whatever the merits of these plans it is certainly not in the national interest to attempt to satisfy all requests for funds irrespective of production efficiency. While many firms started during the postwar period have discontinued operations, they have been replaced by others anxious to make a try at filling the needs of the community. Too liberal a use of monetary artificial respiration will perpetuate firms whose existence cannot be justified on the ground of economic usefulness.

The public debt and the trust funds

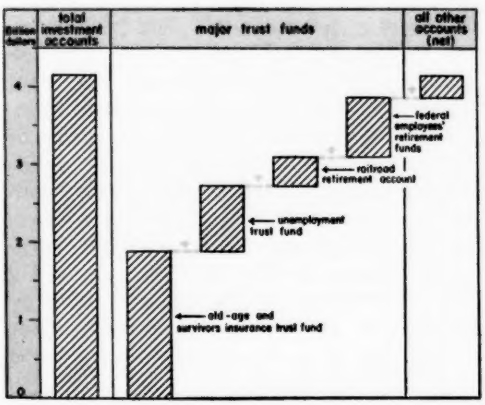
Government trust funds will absorb over 4 billion dollars of public debt issues in fiscal 1953, bridging the gap between the cash and budgetary deficits.

HOW BIG is the budget deficit going to be in the fiscal year 1953? The President in his Budget Message early this year estimated about 14 billion dollars. More recent estimates have tapered this figure down somewhat because of changing prospects on both the receipts and expenditures sides, and there will probably be still further revisions as the months progress. In any event the budgetary deficit will be sizable, and the Treasury will be required for the first time since the Victory Drive at the end of World War II to resort to new borrowing from the public outside the bill market, savings bonds, and other minor issues.

The amount of new borrowing by the Government will be considerably reduced, however, by the presence of one "automatic market," which has been and will continue to absorb substantial amounts of Treasury obligations. This "market" is provided by the Federal Government itself—that is, by the dozens of trust funds and other Governmental agencies, most of whose investments are managed by the Treasury, and almost all of which are required either by law or tradition to invest the bulk of their excess income in Federal securities.

In fiscal 1953, these Government investment accounts should acquire some 4 billion dollars of new issues. While most trust fund investments are not accounted for in the regular budget deficit, the investment of their excess receipts will help materially to finance that deficit in a relatively noninflationary way. In recognition of the increased importance of the funds, more and more people have come to appraise the budget on a "cash" basis, combining "regular" budget and trust fund income and outgo.

How investment account acquisitions of Governments will add up in fiscal '53 . . .



Government-held debt

The phenomenon of Government-held Government debt is not new. It stems from the early post-World War I period when reserve funds were set up by the Government to provide retirement benefits for Federal employees and insurance for veterans. But the volume of trust fund investments was small until the inauguration in the mid-30's of the Social Security accounts and the new credit and insurance agencies.

These programs were established for the most part on a reserve basis, rather than on a pay-as-you-go basis, i.e., contributions to the funds were fixed at a rate which would exceed expenditures in the early years in preparation for growing liabilities in the future. As a re-

sult, total security holdings of the funds have grown steadily, reflecting continued excess of income over expenditures in every year except for a temporary interruption in 1950. During the defense and war years, investments of the existing funds were built up at a particularly rapid rate and, in addition, a large new account was established—the National Service Life Insurance Fund, covering insurance for veterans of World War II.

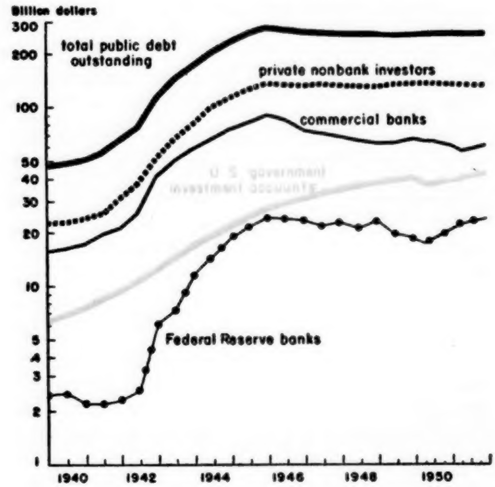
Currently, there are some 60 Government accounts and agencies which hold Federal obligations. They serve a wide variety of specialized purposes and range in size from the 15 billion dollar old-age and survivors insurance fund to few-hundred-dollar gift funds. Their combined holdings of Governments amount to almost 43 billion dollars, more than 16 per cent of the total outstanding public debt and almost twice as much as Federal Reserve Bank holdings. The bulk of these investments, 36 billion, consists of "special issues"—short term, nonmarketable securities designed specifically for individual investment accounts at rates generally set by the Treasury to meet the legal earning requirements of the funds. The major portion of these investments is held by some

Postwar increases in trust fund investments allowed anti-inflationary reductions in publicly-held debt

Fiscal year	Change in outstanding public debt: Total	Held by Govt. investment accounts	Held by public[1]
	(billion dollars)		
1946	+10.8	+ 3.8	+ 7.0
1947	—11.5	+ 3.5	—15.0
1948	— 6.0	+ 3.0	— 9.0
1949	+ .4	+ 2.5	— 2.1
1950	+ 4.6	— .3	+ 4.9
1951	— 2.1	+ 3.6	— 5.7
Total—postwar years	— 3.9	+16.0	—19.9
1952 (est.)	+ 5.0	+ 4.0	+ 1.0
1953 (est.)	+14.7	+ 4.2	+10.5

[1] Includes holdings of Federal Reserve Banks

Government accounts have outpaced other major investor groups in Federal security holdings since 1945



dozen accounts—the three social security funds, the Federal employees' retirement funds, the veterans' life insurance funds, the Federal Deposit Insurance Corporation, and the Postal Savings System.

How investments arise

The various Government trust funds represent money received by the Federal Government which is earmarked for specific groups of beneficiaries. The funds held in trust are not directly available for the general expenditures of the Government. Except for minor amounts of cash retained by the fund disbursing officers, however, receipts in excess of current operations are legally required to be invested and generally in Government securities. In view of the large amounts involved, this is the only practical investment outlet; keeping the reserves in cash could exert a powerful depressive influence on the economy, while investment in private securities, on the other hand, would threaten private ownership and control of American business.

Through such lending of cash to the Treasury in exchange for securities, the net receipts of the trust accounts become available for general Government use. Were it not for the availability of these funds in a period when the Government is not operating at a surplus, the Treasury would be required to borrow or tax an equivalent amount from the public. If at any time expenditures of a trust fund exceed current receipts, the Treasury may redeem that fund's securities by drawing upon its cash balance or borrowing. This happened to the unemployment trust fund in 1949 and 1950 when unemployment claims rose, and to the National Service Life Insurance Fund in 1950 when it paid out a substantial special dividend.

The "investment potential" of the trust funds is limited by their rate of reserve accumulation, that is, by their excess of accumulation of receipts over expenditures. Income of the major accounts consists largely of various forms of cash receipts from the public—primarily payroll taxes, contributions by the Government in some instances, and interest on investments. Expenditures are generally in the form of pensions, annuities, and other types of compensation for risks which the trust funds are designed to cover. Net investment by the funds depends upon such uncontrollable factors as employment levels and general economic conditions as well as upon the statutory bases of the trust funds themselves.

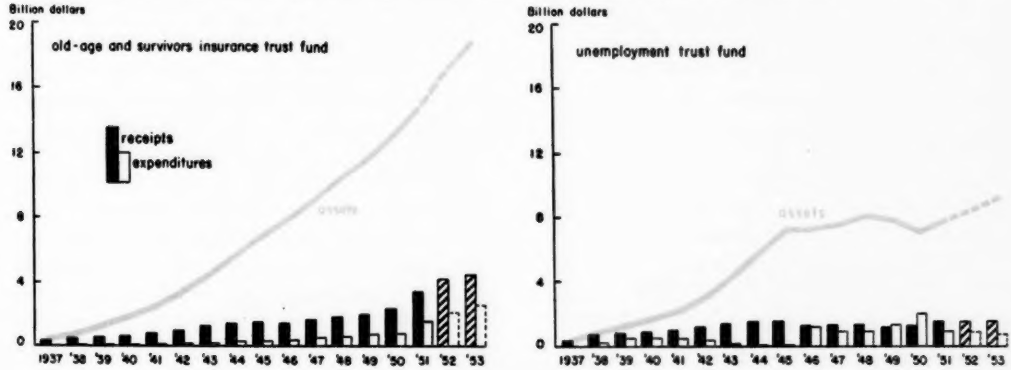
The rate of reserve accumulation varies considerably among the accounts. Under present conditions, only four of the accounts will be absorbing substantial amounts of public debt issues in the period ahead—the Social Security funds, and the Federal employees' retirement funds. The other accounts will either acquire only relatively minor amounts or, as in the case of the National Service Life Insurance Fund, will be experiencing net disbursements.

Reserves vs. pay-as-you-go

The question of the longer range investment potential of the trust funds hinges directly on the degree to which their operations are financed on a pay-as-you-go plan (with tax rates adjusted to match current expenditures), or a reserve plan (with initially higher but stable rates to build up reserves to meet increased future liabilities). As long as the funds are maintained on a reserve or funded basis, they will tend for quite a long period not only

The two largest trust funds: their financial histories compared

The old-age fund has grown steadily since its inception. The unemployment trust fund, however, has experienced marked fluctuations as increased unemployment curtailed receipts and expanded expenditures immediately following World War II and in fiscal years 1949 and '50.



to maintain their current investment position but to expand it as a result of continued net cash inflows plus interest income.

The "to-fund-or-not-to-fund" issue has been the object of much controversy since the inauguration of the Social Security program. The Social Security accounts, as originally set up, were patterned after private insurance plans. Fully funded, they began almost immediately to build up huge investment reserves. The unemployment trust fund, given no change in tax rates, tends to stabilize itself since receipts decline and expenditures rise in periods of unemployment, thus absorbing the reserves built up when business is good and unemployment low. For the old-age fund, however, cash receipts also vary with the level of payrolls against which the tax is levied, but benefit payments tend to expand only gradually as the population matures. As a result, it has become the largest of the Government trust funds and, for this reason, the focal point of the continued reserve-versus-current cost financing debate.

Amendments to the Act in 1939 eliminated the full reserve plan for the old-age fund in favor of a contingency-reserve plus pay-as-you-go, under which each year's benefit payments would in general be met from that year's receipts. Nevertheless, the fund continued to grow rapidly, as a result of the much larger wartime payrolls, even though tax rate increases were skipped until 1950.

The 1950 amendments to the Act brought the fund much closer to a pay-as-you-go basis by expanding coverage and liberalizing benefits. Outlays for benefit payments were thus expanded much more than receipts, particularly in the earlier years. Prior to these latest amendments, costs of the fund would have begun to exceed cash collections (without considering scheduled tax rate increases) somewhere around 1970. The amendments reduced this by some ten years. After that time, the excess of payments will be met from interest income and by redeeming previously accumu-

—continued on page 15

Savings and loans boom

Record increase in savings accounts last year continued rapid postwar growth.

SAVINGS AND LOAN ASSOCIATIONS have been one of the fastest growing types of business in the nation since the end of World War II. In the past six years, the amount of savings invested in share accounts of these institutions has more than doubled, while their mortgage loan holdings have nearly tripled. Total resources have risen from less than 9 billion dollars in 1945 to well over 19 billion by the end of last year, despite a gradual reduction in the number of operating associations.

As a result of this growth, savings and loans have become steadily more important in the financial structure of many communities. Moreover, their significance is increased through specialization. Organized on a cooperative basis, associations obtain their resources largely by attracting savings of people of moderate means; these funds are invested principally in mortgages on small homes located in the immediate locality. Thus, on the one hand, they are aggressive competitors for savings with commercial banks, the Series E savings bond program, and other institutional depositaries. On the other hand, they are the most important single type of lender in the residential mortgage market.

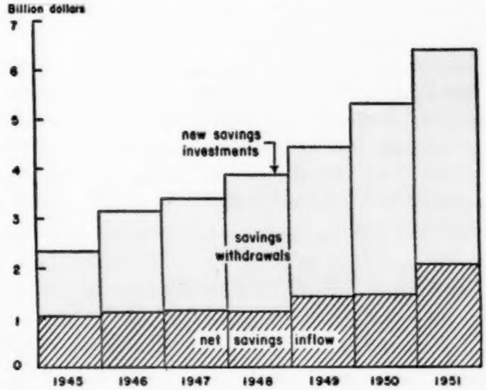
Business has not always been so good. After a rapid growth in the 'twenties, savings and loans were hit hard by the depression. Net resources contracted by nearly a third between 1930 and 1936, then recovered only slightly in the next five years. As a result of the sharp fall in real estate values and widespread delinquencies on mortgage payments, many asso-

ciations were unable to pay holders of share accounts on request.

Although not legally committed to do so, refusal to meet withdrawal demands undoubtedly resulted in a loss of confidence in associations by many potential shareholders. Even during the War, when personal saving was at an all-time high, the growth in savings and loan resources was relatively unimpressive.

The problems of maintaining sufficient liquidity and of avoiding insolvency may again arise to plague savings and loan managers some time in the future. This is not likely to happen, however, so long as real estate prices remain reasonably firm and employment and incomes continue high. Meanwhile, loan associations show every indication of continued rapid growth. Share accounts increased by a record 2 billion dollars in 1951, and the net inflow of savings in the first three months of this year was the largest ever by a wide margin.

Increased savings inflow offset in part by larger withdrawals



Getting the money

Attracting a large volume of savings is the key to savings and loan growth, since other sources of funds—borrowing and accumulation of reserves—are rather limited in magnitude. During the postwar period, the rate of growth in share accounts has averaged 14 per cent per year, second only to the spectacular expansion of open-end investment trusts since 1948. Other savings forms, such as life insurance reserves, commercial bank time deposits, Series E savings bonds, and mutual savings bank deposits, have expanded far less rapidly. Even in dollar terms, only life insurance reserves have exceeded share accounts in growth.

What is the secret of this success in attracting savings? One major factor is the higher rate of return paid on share accounts. According to the U.S. Savings and Loan League, more than three-fourths of a large sample of associations were paying a current dividend of either 2.5 or 3 per cent at the end of 1951. Competitive savings media range from as low as 1 per cent in the case of many commercial banks, to as high as 2.9 per cent, in the case of Series E bonds held to maturity.

A second reason for the rapid growth of savings and loans probably lies in the aggressive merchandising of share accounts by many associations. Primarily, this has taken the form of increased advertising and modernization of facilities. Member associations of the Federal Home Loan Bank System tripled their advertising expenditures between 1945 and 1950. In the same period, the asset value of office buildings and equipment, after depreciation, increased 150 per cent, indicating considerable investment in better quarters.

In their advertising, many associations emphasize that their share accounts are insured against loss up to $10,000 by the Federal Savings and Loan Insurance Corporation. That this has been a factor in improving public confidence in share account safety is suggested by the more rapid growth of insured than of uninsured associations. Many savers apparently do not realize, however, that this insurance protects them only against loss, and not against temporary inability of associations to meet withdrawal requests.

These factors are not the whole answer to

the savings and loans success. Rates of return have generally been higher all along; federal insurance has been available since the middle 'thirties. In part, this success reflects an improvement in business practices. Larger size, better management, closer supervision and examination—all enter into the improvement in status. Perhaps most importantly, the return of savings and loans to public favor is merely a result of the passage of time. Depression experiences, after all, are now almost a generation removed.

Where the money goes

Mortgage loans on residential properties located in the association's community and surrounding area comprise the major investment outlet for savings and loan resources. A few loans are made on income-producing commercial properties and on homes located in distant places, but these are narrowly limited in scope. Associations also invest in Government securities, primarily as an outlet for excess funds and in order to maintain a reasonable liquidity position.

The demand for residential mortgage money has increased tremendously in the postwar period, reflecting the high level of home building and increased prices on existing houses. Nevertheless, savings and loan associations have been able to maintain their leading position in the mortgage market. In addition to the record inflow of savings, associations have obtained funds through liquidation of Government securities, additions to reserves, and increased borrowings. Consequently, the proportion of total residential mortgage debt held by them increased from 27 to 29 per cent between 1945 and 1951, despite a 175 per cent increase in the amount of such debt outstanding.

Credit restrictions and the 20 per cent drop in housing starts last year did not significantly reduce the volume of loans made by associations. Although loans for home construction have increased in recent years, mortgage extensions for purchase of existing homes and other purposes (to which credit restrictions do not apply) still comprise the bulk of their loans (see chart). In addition, savings and loans make most mortgages on a conventional noninsured basis. Credit terms on these mortgages were already about as strict for moderately priced homes as those required by Regulation X.

Liquidity a problem

A significant trend in the postwar period has been the steady and rapid rise in the volume of savings withdrawals (see chart). Net additions to share accounts have increased only because associations have attracted new savings in even greater volume. A major part of the rise in withdrawals can be attributed to the expansion in share account holdings. In addition, however, it evidences an increased turnover of accounts. This suggests that more people are actively using savings and loan associations as a depositary for their liquid funds, and expect frequent withdrawal requests to be honored as a matter of course.

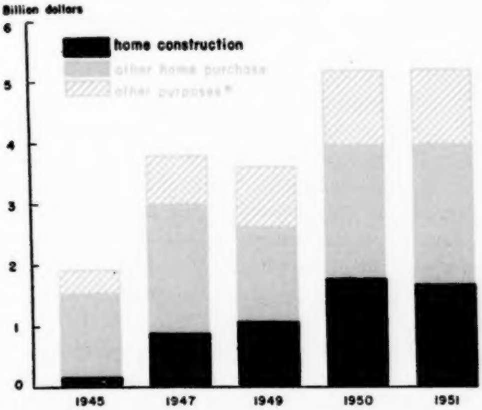
In consequence, the need for savings and loan liquidity is increased. New savings inflow could drop

Some measures of savings and loan growth

	Total assets	Mortgage loans	Cash and Government securities	Share capital	Reserves
	(million dollars)				
1940	5,670	4,370	370	4,270	460
1945	8,750	5,520	2,870	7,360	640
1949	14,620	11,710	2,340	12,470	1,110
1950	16,930	13,810	2,400	14,080	1,290
1951[1]	19,250	15,800	2,600	16,180	1,500

[1]Estimated

Mortgage loan extensions up sharply in 1950 and 1951



* Includes refinancing home repair and modernization, and other loans

abruptly, while withdrawals—more closely related to total share account holdings—are likely to remain high. Holdings of cash and Government securities have not been increased over the postwar period, reflecting the heavy demand for mortgage credit. As a result, the proportion of these liquid assets to share capital has dropped from 40 per cent in 1945 to about 16 per cent at the end of 1951.

Moreover, borrowings and other current liabilities have increased substantially in the same period. At the end of 1950, they amounted to 60 per cent of liquid asset holdings. Thus, the liquidity of associations as a group has declined drastically as a result of rapid share account expansion and a large mortgage loan demand. It should be noted, however, that access to emergency borrowing from the Federal Home Loan Banks reinforces the liquidity position of member associations in case of need.

There seem to be only two answers to this problem. First, associations should maintain conservative loan to value ratios on uninsured mortgages. The extent to which this can be done is limited by the necessity of competing with FHA and VA terms for the available mortgage business. Second, reserve and undivided profits balances should be built up in order to provide a buffer for absorbing losses. Unfortunately it has been difficult to increase reserve ratios because of the rapid expansion in share accounts and the pressure to maintain and increase dividend rates.

Public debt—*continued from page 12*

lated holdings of Government securities.

Of course, the more the trust funds are redesigned to conform to the pay-as-you-go principle, the less impact they will have upon Government debt operations. Study on the subject is still underway and from it may emerge further significant legislative changes in the financing plans of the funds. Up for consideration are issues—such as distribution of the over-all tax burden—which far transcend the investment potential of the accounts.

Unless some drastic changes are made, however, the trust fund reserves will continue to grow for several years, absorbing a part of the public debt in the process. The rate of growth will depend in part upon continued prosperity and, in any event, will not match the rapid expansion of the 1940's. But during 1953, the estimated 4 billion dollar accumulation in trust fund reserves will provide the Treasury with its most certain and least inflationary vehicle for financing the expected budget deficit.

Business Conditions *is published monthly by the* FEDERAL RESERVE BANK OF CHICAGO. *Subscriptions are available to the public without charge. For information concerning bulk mailings to banks, business organizations, and educational institutions, write: Research Department, Federal Reserve Bank of Chicago, Box 834, Chicago 90, Illinois. Articles may be reprinted provided source is credited.*

Deposit survey

PRIVATELY OWNED DEMAND DEPOSITS in Seventh District banks totaled almost 14½ billion dollars at the end of January 1952. This marked a new high in deposits of individuals and business organizations, over 5 per cent larger than the previous peak recorded a year ago.

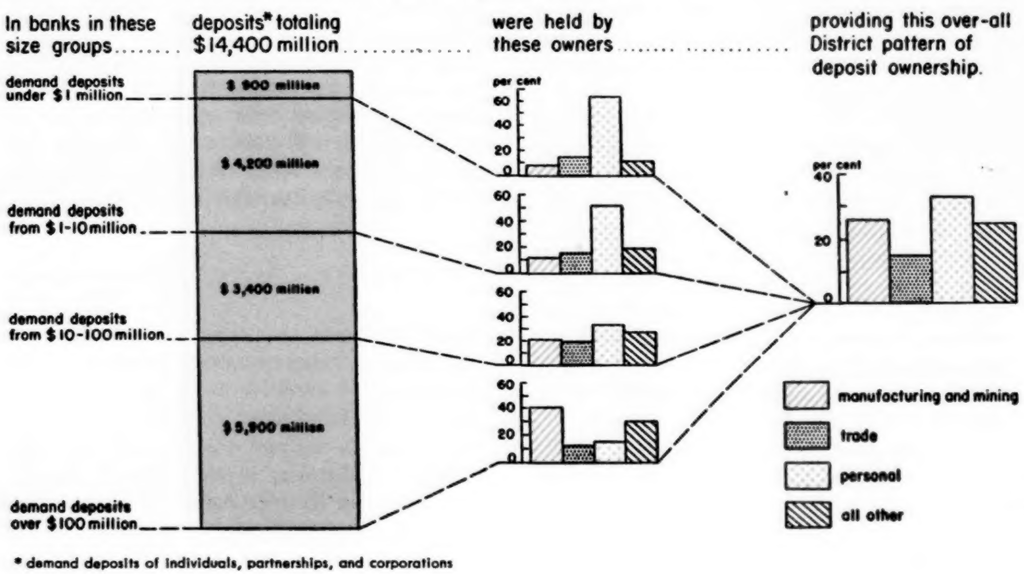
According to estimates based on the annual Survey of Demand Deposits in the Seventh Federal Reserve District, the two largest components, personal accounts and manufacturing and mining accounts, grew moderately over the year. The highest percentage gains, however, were experienced by nonprofit organizations such as relief societies, hospitals, and schools. The need for expanding construction programs on the one hand, and increased personal saving and the tax deductible features of donations on the other, probably accounted for the larger holdings. Deposits of contractors, builders, hotels, and others—mostly small service firms—also climbed substantially, while insurance company accounts rose almost 10 per cent above year-ago levels. The only major decline was shown in public utility demand deposits.

Personal accounts in District banks equaled almost 5 billion dollars on January 31, 1952. These accounts actually declined, however, in the largest banks, while the number and size of demand deposit accounts rose in the smallest banks over the past year. The fact that farmer accounts, constituting slightly more than 10 per cent of personal accounts, remained fairly stable, suggests that increases in personal savings in 1951 may have been centered in lower income and rural nonfarm groups.

In general, noncorporate businesses and organizations, which obtain funds largely from consumer savings such as nonprofit institutions and insurance companies, made the major 1951 gains.

The actual structure of demand deposits as of January 31, 1952 is shown below.

Holdings of demand deposits, January 31, 1952



* demand deposits of individuals, partnerships, and corporations